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Supreme Court of the United States

OCTOBER TERM, 1945

No. 5

STATE OF NEW YORK and SARATOGA SPRINGS COMMISSION and SARATOGA SPRINGS AUTHORITY,

Petitioners,

v.

UNITED STATES OF AMERICA.

BRIEF ON REARGUMENT, FOR THE STATE OF NEW YORK, PETITIONER

NATHANIEL L. GOLDSTEIN,
Attorney-General of the State of New York,
Attorney for State of New York, Petitioner.

ORRIN G. JUDD,
Solicitor General.

WENDELL P. BROWN,
First Assistant Attorney-General.

HENRY S. MANLEY,
Assistant Attorney-General.

IRVING I. WAXMAN,
Deputy Assistant Attorney-General,
of Counsel.

Also joining in the brief:

DENIS J. HARRINGTON,
Attorney for Saratoga Springs Commission
and Saratoga Springs Authority.

JOHN A. SLADE,
of Counsel.

INDEX

	PAGE
Introductory	1
Outline of Argument	4
POINT I—A tax which is imposed directly upon state property or a state activity or the income therefrom is unconstitutional even though non-discriminatory	5
POINT II—The disposal by a state of its natural resources, and particularly of water, is a governmental activity constitutionally immune from federal taxation	15
State exploitation of natural resources is a governmental activity	15
The supply and conservation of water is a governmental activity	17
POINT III—The fact that a state, in enlarging its property or activities, enters a field which would be taxable as a private enterprise, does not constitute a ground for denying tax immunity	22
(1) The states should be given the same freedom from tax burdens in enlarging their activities within the fields reserved to the states that the Federal Government has within the powers delegated to it	26
(2) The general rule is, and should continue to be, that the immunities of the states and of the Federal Government are reciprocal	32
(3) No previous case has sustained a federal tax upon a public service rendered by a state or political subdivision	42
Conclusion	50
Appendix A	52

TABLE OF CASES PAGE

Alabama State Federation of Labor v. McAdory, 325 U. S. , 65 Sup. Ct. 1384 32
Allen v. Regents, 304 U. S. 439 ..... 12, 44, 47, 48
Ambrosini v. United States, 187 U. S. 1 36
Ashton v. Cameron County Water Improvement District, 298 U. S. 513 37
Ashwander v. Tennessee Valley Authority, 297 U. S. 288 16

Bank of United States v. Planters' Bank of Georgia, 9 Wheat. 904 28
Bernardine v. City of New York, 294 N. Y. 361 43
Board of Trustees v. United States, 289 U. S. 48 25
Brush v. Commissioner, 300 U. S. 352 ..... 17, 37, 43, 50
Burnet v. Coronado Oil & Gas Co., 285 U. S. 393 15, 28, 38

Champlin Refining Co. v. Corporation Commission, 286 U. S. 210 16
City of Cleveland v. United States, 323 U. S. 329 ..... 12, 26
Collector v. Day, 11 Wall. 113 ..... 6, 34, 38
Coxe v. State, 144 N. Y. 396 20

Doblins v. Commissioner, 16 Pet. 434 38

East New York Savings Bank v. Hahn, 325 U. S. 42
Educational Films Corp. v. Ward, 282 U. S. 379 ... 36

Farmers and Mechanics Savings Bank v. Minnesota, 232 U. S. 516 36
Federal Land Bank v. Bismarck Lumber Co., 314 U. S. 95 ..... 26, 39
Federal Land Bank v. Crosland, 261 U. S. 374 12
Ford Motor Co. v. Department of Treasury, 323 U. S. 459 32

Gillespie v. Oklahoma, 257 U. S. 501 39
Gillis v. California, 293 U. S. 62 44
Graves v. New York ex rel. O'Keefe, 306 U. S. 466 ..... 26, 33, 39
Graves v. Texas Company, 298 U. S. 393 41
Gregg Dyeing Co. v. Query, 286 U. S. 472 13
Green v. Frazier, 253 U. S. 233 31

PAGE

Helvering v. Gerhardt, 304 U. S. 405 . . . 5, 11, 12, 13, 39, 43
Helvering v. Mountain Producers Corporation, 303 U. S. 376 . . . . . 10, 15, 38
Helvering v. Powers, 293 U. S. 214 43
Helvering v. Therrell, 303 U. S. 218 38
Hopkins Federal Savings and Loan Association v. Cleary, 296 U. S. 315 39
Hudson Co. Water Co. v. McCarter, 209 U. S. 349 . . 20

Illinois Central R. R. Co. v. Illinois, 146 U. S. 387 . . 20
Indian Motocycle Co. v. United States, 283 U. S. 570 . . 9, 38
Irwin v. Gavit, 268 U. S. 161 23

Kaukauna Water Power Co. v. Green Bay Canal Co., 142 U. S. 254 19
Keifer & Keifer v. Reconstruction Finance Corp., 306 U. S. 381 26

Lindsley v. Natural Carbonic Gas Co., 220 U. S. 61 . . 16

Manigault v. Springs, 199 U. S. 480 42
Maricopa County v. Valley National Bank, 318 U. S. 357 12
Matter of Niagara Falls Power Co. v. Water Power and Control Commission, 267 N. Y. 265 20
Mayo v. United States, 319 U. S. 441 12
McCulloch v. Maryland, 4 Wheat. 316 . . . . . 5, 33
Metcalf & Eddy v. Mitchell, 269 U. S. 514 . . . . . 3, 8, 36
Michigan v. Michigan Trust Co., 286 U. S. 334 44
Muller v. Oregon, 208 U. S. 412 31
Murray v. Wilson Distilling Co., 213 U. S. 151 48

National Labor Relations Board v. Hearst Publications, Inc., 322 U. S. 111 43
New State Ice Co. v. Liebman, 285 U. S. 262 28
New York ex rel. Bank of Commerce v. Commissioners of Taxes, 2 Black 620 34
New York ex rel. Cohn v. Graves, 300 U. S. 308 38
New York ex rel. Rogers v. Graves, 299 U. S. 401 . . 44
Noble State Bank v. Haskell, 219 U. S. 104 31
North Carolina v. United States, 325 U. S. , 65 Sup. Ct. 1260 32
Northwest Airlines, Inc. v. Minnesota, 322 U. S. 292 13

PAGE

Ohio v. Helvering, 292 U. S. 360 ..... 44, 46

Parker v. Brown, 317 U. S. 341 24
Pennsylvania v. West Virginia, 262 U. S. 553 20
Plummer v. Coler, 178 U. S. 115 35
Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429 ..... 7, 35
Puget Sound Power & Light Co. v. Seattle, 291 U. S. 619 27

Reconstruction Finance Corp. v. Menihan Corp., 312 U. S. 81 26

Smith v. Davis, 323 U. S. 111 12
Snyder v. Bettman, 190 U. S. 249 38
South Carolina v. United States, 199 U. S. 437 13, 20, 42, 44, 45, 46, 48, 50
Spector Motor Service, Inc. v. McLaughlin, 323 U. S. 101 32
Standard Oil Co. v. Johnson, 316 U. S. 481 18

Texas Co. v. Carmichael, 13 F. Supp. 242 41
Thomas v. Collins, 323 U. S. 516 23
Tompkins v. Erie Railroad Co., 304 U. S. 64 33
Trinityfarm Construction Co. v. Grosjean, 291 U. S. 466 37

United States v. Allegheny County, 322 U. S. 174 ..... 12, 13, 17
United States v. California, 297 U. S. 175 ..... 24, 25, 37, 49
United States v. Perkins, 163 U. S. 625 38
United States v. Railroad Co., 17 Wall. 322 ..... 6, 8, 23

Van Brocklin v. Tennessee, 117 U. S. 151 ..... 7, 17
Veazie Bank v. Fenno, 8 Wall. 533 ..... 6, 25

Weston v. City Council of Charleston, 2 Pet. 449 .. 5, 7
Willcuts v. Bunn, 282 U. S. 216 9

Table of Statutes

PAGE

New York Statutes

Constitution, Art XVIII 41

Public Housing Law 41

Saratoga Springs Reservation Law

L. 1930, c. 866 52

State Insurance Fund

L. 1913, c. 816 31

L. 1914, c. 41 31

Workmen's Compensation Law, Art. 6 31

United States Statutes

Constitution

Art. VI, § 2 33

Tenth Amendment 28

Longshoremen's and Harbor Workers Compensation Act (33 U. S. C. A. §§ 901, *et seq.*) .. 31

Revenue Act of 1917, § 313-c (40 Stat. 312) 48

Revenue Act of February 24, 1919 (40 Stat. 1149) 48

Revenue Act of 1932, § 615 (a) (5)—(47 Stat. 265) 52

Revenue Act of 1934, § 601 (48 Stat. 762) 48

Table of Other References

PAGE

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Dewey, Gov. Thomas E.,—Public Papers (1943) ... 19

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Frankfurter, Felix, *Mr. Justice Holmes and the Supreme Court* (1938) 12

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PAGE

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Roosevelt, Gov. Franklin D.,—Public Papers (1929) 19
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Warren, *The Supreme Court and Sovereign States* (1924) 28
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Introductory

Certiorari was granted by this Court on June 12, 1944, and the case was No. 83 on the calendar for the October 1944 Term. It was argued on December 7 and 8, 1944. Reargument was directed on June 18, 1945, and on October 8, 1945, the Court invited attention to the following questions:

> "1. May Congress constitutionally include for taxation in a generally applicable taxing act any state property or activity or the income derived by the state from them, or any other source, so long as the tax does not discriminate against the state, or so long as the tax is not laid on the interest taxed, merely because it is that of a state—and if income of a private person from a like source may be constitutionally taxed?
>
> "2. To what extent may a state, by enlarging its property ownership or its activities, withdraw from

of a rule which would permit inclusion of state and municipal activities within the scope of any and all non-discriminatory federal taxing statutes, merely because a private person would be taxable under the same circumstances, is wholly unjustified and unfair. Such a rule would defeat the reasonable expectations of those who purchased state and municipal bonds in good faith, and would seriously handicap the States in their legitimate activities.

Outline of Argument

I. A tax which is imposed directly upon state property or a state activity or the income therefrom is unconstitutional, even though non-discriminatory. (Answering question 1 above.)

II. The disposal by a state of its natural resources, and particularly of water, is a governmental activity constitutionally immune from federal taxation. (Supplementing our original brief on this point.)

III. The fact that a state, in enlarging its property ownership or its activities, enters a field which would be taxable as a private enterprise, does not constitute a ground for denying it tax immunity. (Answering question 2 above.)

(1) The States should be given the same freedom from tax burdens in enlarging their activities within the fields reserved to the States that the Federal Government has within the powers delegated to it.

(2) The general rule is, and should continue to be, that the immunities of the States and of the Federal Government are reciprocal.

(3) No previous case has sustained a federal tax upon a public service rendered by a state or political subdivision.

POINT I

A tax which is imposed directly upon state property or a state activity or the income therefrom is unconstitutional even though non-discriminatory.

The general tenor of the decisions of this Court over more than a century of time is, that any tax imposed by one government directly on another is *prima facie* a violation of the fundamental principle of intergovernmental tax immunity. The cases where special circumstances have led the Court to uphold a tax against a state will be treated in Point III of this brief. But the fact that a tax is non-discriminatory has never been considered in itself a justification for the tax.

The decision in the first case on intergovernmental immunity (*McCulloch* v. *Maryland*, 4 Wheat. 316) did not turn on the fact that the tax involved was discriminatory, although the tax was in fact confined to banks not chartered by the State Legislature (p. 320). Chief Justice Marshall stated (pp. 436-437):

> "This is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."

The next case on the subject involved a nondiscriminatory tax. In *Weston* v. *City Council of Charleston*, 2 Pet. 449, Chief Justice Marshall struck down a local tax as applied to stock in the Bank of United States because "it bore directly upon the contract evidenced by the stock" and because "if the right to impose the tax exists, it is a right which in its nature acknowledges no limits" (p. 466). See *Helvering* v. *Gerhardt*, 304 U. S. 405, 413, where Mr. Justice, now Chief Justice, Stone recognized the *Weston* case as establishing the rule "that federal instrumentalities are similarly immune from nondiscriminatory state taxation."

The correlative immunity of the states found expression in *Veazie Bank* v. *Fenno*, 8 Wall. 533, which upheld a federal tax on notes issued by a bank chartered by the State of Maine, but not sustaining any relation to the State as a financial agent (p. 535), the Court stating (p. 547):

> "It may be admitted that the reserved rights of the States, such as the right to pass laws, to give effect to laws through executive action, to administer justice through the courts, *and to employ all necessary agencies for legitimate purposes of State government*,* are not proper subjects of the taxing power of Congress."

We have already quoted the language of Mr. Justice Nelson in *Collector* v. *Day*, 11 Wall. 113, 127 (main brief, p. 7), that the exemption of state instrumentalities from federal taxes "rests upon necessary implication, and is upheld by the great law of self-preservation." The tax involved in *Collector* v. *Day* was the Civil War income tax on the income "of every person residing in the United States." While it has now been held that a tax on salaries is not a direct burden on the government which pays the salaries, *Collector* v. *Day* still stands for the principle that any direct burden upon a state function, even though not discriminatory, is unconstitutional.

It was a non-discriminatory federal tax upon the bonds of transportation companies which was held invalid as to the City of Baltimore in *United States* v. *Railroad Co.*, 17 Wall. 322. The Court there stated (p. 327):

> "The power of taxation by the Federal government upon the subjects and in the manner prescribed by the act we are considering, is undoubted. There are, however, certain departments which are excepted from the general power. The right of the States to administer their own affairs through their legislative, executive and judicial departments, in their

* Italics throughout this brief are inserted by counsel, unless otherwise noted.

> own manner through their own agencies, is conceded by the uniform decisions of this court and by the practice of the Federal government from its organization. This carries with it an exemption of those agencies and instruments, from the taxing power of the Federal government."

The argument was made there, in substance, that an investment in a railroad was not a strictly governmental purpose, just as it is argued here that the selling of bottled water is not a strictly governmental activity, but the Court held that the legislative grant of power to invest in such bonds "was conferred because its exercise concerned the public and to benefit that public" (p. 331) and concluded, "We are clear in the opinion that the present transaction is within the range of the municipal duties of the city, and that the tax cannot be collected": (p. 333).

Lands of the United States were held exempt from state taxation in *Van Brocklin* v. *Tennessee*, 117 U. S. 151. The lands had been acquired for non-payment of direct taxes laid by Congress, and were afterwards sold by the United States for a sum larger than the original tax and penalties. Neither the fact that the tax was non-discriminatory nor the contention that Tennessee had never ceded exclusive jurisdiction over the land to the United States, availed to save the tax.

It was again a non-discriminatory income tax which was held invalid as to state and municipal securities in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429. The opinion of Chief Justice Fuller stated (p. 586):

> "Applying this language* to municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the

* The reference is to Chief Justice Marshall's opinion in *Weston* v. *Charleston, supra* (2 Pet. 449, 468), holding that a state tax could not be applied to stock in the Bank of the United States.

> contract, and that *the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the Constitution.*"

All the Justices agreed on this phase of the case. Mr. Justice Field's opinion quoted (p. 603) *United States* v. *Railroad Co.*, 17 Wall. 322, 327, that the power of the states to administer their own agencies "carries with it an exemption of those agencies and instruments from the taxing power of the Federal government." Mr. Justice White stated (p. 652) that "In regard to the right to include in an income tax the interest upon the bonds of municipal corporations, I think the decisions of this court, holding that the Federal government is without power to tax the agencies of the state government, embrace such bonds, and that this settled line of authority is conclusive upon my judgment here." Mr. Justice Harlan stated (p. 653) that "The instrumentalities employed by the States in execution of their powers are not subjects of taxation by the general government, any more than the instrumentalities of the United States are the subjects of taxation by the States." The opinions on reargument adhered to this same view (158 U. S. 601 at 630, 665-666, 693).

State and federal immunities were considered comparable in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, which sustained a federal income tax upon the compensation of a consulting engineer engaged by a state. The Court, by Mr. Justice Stone, stated (pp. 522-23):

> "Just what instrumentalities of either a state or the federal government are exempt from taxation by the other cannot be stated in terms of universal application. But this Court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other. * * * it rests on the conviction that each government, in

order that it may administer its affairs within its own sphere, must be left free from undue interference by the other."

When this Court in *Willcuts* v. *Bunn*, 282 U. S. 216, sustained an income tax upon profits made from the sale of municipal bonds, it based its decision not alone on the fact that the tax was non-discriminatory, but treated as decisive the fact that a tax on such a transaction did not directly burden the state, and that any injury to the state's borrowing power was imaginary and negligible (pp. 229-234). Chief Justice Hughes stated (pp. 224-25):

> "The well-established principle is invoked that a tax upon the instrumentalities of the States is forbidden by the Federal Constitution, the exemption resting upon necessary implication in order effectively to maintain our dual system of government.
>
> * * * * * *
>
> The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, *and* where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government."

A non-discriminatory tax was before this Court in *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, involving an excise tax which the Court found was levied on the sale of motorcycles. It was there held that the tax could not be imposed on the sale of a motorcycle to a municipal corporation for use in its police service. Mr. Justice Van Devanter declared (pp. 575-76):

> "It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the States exert the

governmental powers belonging to them are equally exempt from taxation by the United States. This principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. *Collector* v. *Day*, 11 Wall. 113, 125, 127; *Willcuts* v. *Bunn*, 282 U. S. 216, 224-225. Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute. *McCulloch* v. *Maryland*, 4 Wheat. 316, 430; *United States* v. *Baltimore & Ohio R. Co.*, 17 Wall. 322, 327; *Johnson* v. *Maryland*, 254 U. S. 51, 55-56; *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505; *Crandall* v. *Nevada*, 6 Wall. 35, 44-46."

A non-discriminatory tax must still meet the test that it is not imposed directly upon a state or municipal government. The recent redefinition of the scope of immunity, permitting taxes which may indirectly burden a government, has no tendency to indicate that a non-discriminatory tax laid directly upon a State or municipal activity will be sustained.

It seems to be accepted that the present case involves a direct tax upon the state. The United States does not now and never has argued against that proposition. Federal taxes which are a direct burden upon state activities are not valid simply because they do not discriminate against the state and are not laid on the interest taxed merely because it is that of a state.

The necessity that a tax not only be non-discriminatory but that it not be laid directly upon the state, was repeated in *Helvering* v. *Mountain Producers Corporation*, 303 U. S. 376, which upheld an income tax on a lessee of state oil lands. The question which Chief Justice Hughes considered vital in the *Mountain Producers* case was—

"whether in a case where the tax is not laid upon the leases as such, or upon the government's prop

erty or interest, but is imposed upon the gains of the lessee, like that laid upon others engaged in similar business enterprises, there is in truth such a direct and substantial interference with the performance of the government's obligation as to require immunity for the lessee's income" (p. 384).

The fact that the tax was not directly upon the state was the reason for upholding it. The Court stated (p. 387):

> "In the instant case, we find no ground for concluding that the tax upon the profits of Wyoming Associated derived under its lease from the State constituted any direct and substantial interference with the execution of the trust which the State has assumed."

When this Court held in *Helvering* v. *Gerhardt*, 304 U. S. 405, that the Federal Government might tax the income of the employees of state agencies, it did not find that the non-discriminatory character of the income tax was sufficient to remove the case from state immunity, but it pointed out the lack of any direct burden upon the state, saying (p. 421):

> "The effect of the immunity if allowed would be to relieve respondents of their duty of financial support to the national government, in order to secure to the state a theoretical advantage so speculative in its character and measurement as to be unsubstantial. A tax immunity devised for protection of the states as governmental entities cannot be pressed so far.
>
> "The fact that the expenses of the state government might be lessened if all those who deal with it were tax exempt was not thought to be an adequate basis for tax immunity in *Metcalf & Eddy* v. *Mitchell, supra*, in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, in *Burnet* v. *Jergins Trust*, 288 U. S. 508; or in *Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376. When immunity is claimed from a tax laid on private persons, it must clearly appear that the burden upon the state function is actual and substantial, not conjectural. *Willcuts* v. *Bunn, supra*, 231. The extent to which salaries in business or professions whose standards of compensation are otherwise fixed by competitive con-

ditions may be affected by the immunity of state employees from income tax is to a high degree conjectural."

It is true that the Court has observed in cases where it has permitted a tax against state agencies that the tax was non-discriminatory (See, *e. g., Allen* v. *Regents,* 304 U. S. at 452). But it would be a *non sequitur* to assert that every non-discriminatory tax is valid.

In determining the extent of federal immunity from state taxation this Court has adhered to the rule that a tax directly upon a governmental activity is invalid even though non-discriminatory. *Federal Land Bank* v. *Crosland,* 261 U. S. 374; *Maricopa County* v. *Valley National Bank,* 318 U. S. 357; *Mayo* v. *United States,* 319 U. S. 441; *City of Cleveland* v. *United States,* 323 U. S. 329; cf. *Smith* v. *Davis,* 323 U. S. 111.

Mr. Justice Jackson has summarized the Court's decisions by stating that:

> "The distinction between taxation of private interests and taxation of governmental interests, although sometimes difficult to define, is fundamental in application of the immunity doctrine as developed in this country."
>
> *United States* v. *Allegheny County,* 322 U. S. 174, 186.

See also T. R. Powell, *The Remnant of Intergovernmental Tax Immunities,* 58 Harv. L. Rev. 757, 786-87.

Mr. Justice Frankfurter, who had earlier called attention to the unjustified extension of the immunity doctrine to subjects not directly affecting the State or Federal Governments,* has described the present basis of the Federal Government's immunity in the following terms:

> "The basis of the doctrine was shifted from that of an argumentative financial burden to the Federal Govern-

* Frankfurter, *Mr. Justice Holmes and the Supreme Court* (1938) 85. These lectures were given in April, 1938, and doubtless prepared some time before this Court's opinions in *Helvering* v. *Gerhardt, supra* (304 U. S. 405), decided May 23, 1938.

ment to that of freedom from discrimination against transactions with the Government *and freedom from direct impositions upon the property and the instrumentalities of the Government.*"

United States v. *Allegheny County*, 322 U. S. 174, 196.

It may be suggested that the trend of the Court to approve taxes which only indirectly burden the state or federal governments should lead also to a relaxation of the rules against direct burdens. Logic seems to point in the opposite direction. The right to impose taxes upon persons who deal with or work for the state or federal governments removes the danger of serious restriction upon the taxing power, and thus removes one of the main reasons which led this Court to make exceptions to the doctrine of state immunity in *South Carolina* v. *United States*, 199 U. S. 437.

The exemption of state or federal employees from general income taxes was objectionable as tending to create a "privileged class of taxpayers" (*Helvering* v. *Gerhardt*, 304 U. S. 405, at 416). Recognition of immunity from taxes laid directly upon a state activity has no such effect. On the contrary, the tendency if such immunity were denied would be to discourage state pioneering in new activities, as we shall more fully outline in a later Point.

A ruling under which all non-discriminatory taxes would be approved does not even have the advantage of simplicity. There are indications in the cases, however, that it is not always easy to tell what is a discriminatory tax. *Gregg Dyeing Co.* v. *Query*, 286 U. S. 472; *Cf. Northwest Airlines, Inc.* v. *Minnesota*, 322 U. S. 292. It might be considered discriminatory as against the states to tax a state activity in a field where the Federal Government is also operating and is free from tax; regardless of the manner in which private business is treated, the collection of a tax from a state activity and the exemption of a comparable federal activity would seem to be the equivalent

to laying a tax on the activity merely because it is that of a state. In any event, a fancied simplicity of application should be a less important consideration in adopting a standard of immunity than that of consistency with prior rulings of this Court, or that of its practical effect upon the States.

Taxes which are imposed directly upon a state activity tend to discourage the state from embarking on that activity. The long-established rulings of this Court forbid such direct burdens, and ought not to be overruled.

The principle of intergovernmental tax immunity is based on implication from the existence of state and federal governments within the same territory. But even the limited immunity suggested by this Court's first question—an immunity from taxes discriminating against state activity—must rest on implication rather than on express language. We know of no reason which would compel the adoption at this late date of an interpretation which would so limit the immunity of the States. On the contrary, we shall show that such a doctrine would have serious consequences to our state and local governments. In the face of repeated statements by this Court that immunity extends to non-discriminatory taxes, there is no justification for now excluding all such taxes from the scope of the immunity.

POINT II

The disposal by a state of its natural resources, and particularly of water, is a governmental activity constitutionally immune from federal taxation.

This Court has recognized as legitimate fields of state activity, entitled to constitutional immunity, both the exploitation of natural resources and the development of water supply.

State exploitation of natural resources is a governmental activity.

Burnet v. *Coronado Oil & Gas Co.*, 285 U. S. 393, stands for two propositions: First, that an oil lease covering state-owned lands is an instrumentality of the state in the exercise of a governmental function, and second, that application of the federal income tax to the income derived from the lease by the lessee is a direct burden upon the state government. The second proposition has now been repudiated (*Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376) on the ground that the tax was not a direct and substantial burden upon the state. But the first proposition, that the activity was governmental, has not been disturbed. The Court said on this point (285 U. S. at 400):

> "When Oklahoma undertook to lease her public lands for the benefit of the public schools she exercised a function strictly governmental in character. Consequently, *South Carolina* v. *United States*, 199 U. S. 437, much relied upon, is not in point."

The Oklahoma Legislature had directed payment of the proceeds of the oil leases into the school fund (285 U. S. at 398) to provide free public education. New York utilizes the proceeds of sale of Saratoga Spring waters for payment of the current expenses of the Saratoga Springs Reservation, so that it may provide free treatments for needy and ailing citizens at Saratoga Springs (R. 17-19).

The acts of the State of New York, in bottling and selling the mineral waters of Saratoga Springs for the benefit of the public health, are no less governmental in character than the actions of Oklahoma in leasing its oil lands for the benefit of public education (see State's original brief, pp. 12-13).

Another example illustrates the anomaly which might result from denial of immunity for a state's disposal of natural resources. The National Government and State

Governments own forests, and presumably in years to come will engage in harvesting timber even more extensively than at present. It is quite conceivable that each may impose an excise tax measured by all severances of timber within the respective taxing jurisdiction. To distinguish between the two cases upon the ground that lumbering operations of the Federal Government are necessarily "governmental" and hence immune, but that such operations of a state are "proprietary" and taxable, will not be a satisfactory contribution to clarity of constitutional doctrine.

Nor should the circumstance that the mineral springs at Saratoga were at one time in private hands alter the governmental character of their present operation. The reason why the state reacquired the waters at Saratoga was that private operation had proved wasteful and detrimental to the conservation of those waters in the interest of public health (R. 12-13).* States have been held to have a legitimate interest in the efficient use of their natural resources *Champlin Refining Co.* v. *Corporation Commission,* 286 U. S. 210; *cf. Lindsley* v. *Natural Carbonic Gas Co.,* 220 U. S. 61.

The Court in *Ashwander* v. *Tennessee Valley Authority,* 297 U. S. 288, 330-40, construed broadly the power of the Federal Government to dispose of property it had ac-

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* Another reason may well have been the necessity for strict control of the bottling, in order to preserve the virtues of the waters. The process used in bottling was worked out by State employees before the lease to Saratoga State Waters Corporation was made in 1920. See 1932 Annual Report of Saratoga Springs Commission, 1933 N. Y. Leg. Doc. No. 96, p. 19. The process includes filling the empty bottle with carbon dioxide before waters are introduced into it, and storing it to let any sediment settle. 1937 Annual Report, p. 13. The process is an expensive one, and the Saratoga waters are substantially the only waters in the eastern United States which are bottled in their natural state (1938 Annual Report, p. 7).

quired, and left no doubt that this is a governmental power. The same should be true when a state disposes of its property.

The extent of the state's power in the development and use of its natural resources should not be diminished by the fact that it had been necessary to correct the mistake of a previous commission which had permitted those resources to pass temporarily into private hands.* It may be pointed out, moreover, that the lands of the Federal Government which were held constitutionally tax exempt in *Van Brocklin* v. *Tennessee,* 117 U. S. 151, were lands which had once been in private hands, and the machinery which was given constitutional immunity in *United States* v. *Allegheny County,* 322 U. S. 174, had doubtless been bought from a private manufacturer.

The supply and conservation of water is a governmental activity

The state's immunity in the present case does not rest alone upon the general governmental character of any disposal of a public natural resource. Water is peculiarly the subject matter of governmental activity, as this Court has expressly recognized.

In *Brush* v. *Commissioner,* 300 U. S. 352, the Court reviewed the history of water supply, and held that an employee of the Bureau of Water Supply of the City of New York was performing a governmental function, and was therefore immune from federal income tax. (As in other salary cases, we consider it clear that the determination of the immune character of the activity survives even though a tax on salaries is no longer con-

* The lease of the bottling privileges by the Saratoga Springs Reservation Commission had met with prompt and strong opposition from those who considered that the distribution of the waters should not be primarily a trade undertaking but a public health undertaking. Lasker, *The Wand of Manitou,* 44 The Survey 329, 333 (1920).

sidered a direct burden on the activity.). The Court there stated:

> "The public interest in the conservation and distribution of water for a great variety of purposes—ranging from ordinary agricultural, domestic and sanitary uses, to the preservation of health and of life itself—is obvious and well settled" (p. 366).
>
> "We conclude that the acquisition and distribution of a supply of water for the needs of the modern city involve the exercise of essential governmental functions, and this conclusion is fortified by a consideration of the public uses to which the water is put" (p. 370).

The question whether the activity was profitable was not considered decisive, the Court stating:

> "If that service be governmental it does not become private because a charge is made for it, or a profit realized" (300 U. S. at 372).

Likewise, the fact that Army post exchanges operate at a profit has not been considered a sufficient reason for denying that they are essential for the performance of governmental functions. *Standard Oil Co.* v. *Johnson*, 316 U. S. 481.

Although the sale of water from Saratoga Springs results in some profit, when computed without depreciation or other capital charges (R. 18), the annual operating receipts of the reservation as a whole have never been sufficient to meet its expenses (R. 20).

The fact that the water involved in the present case is sold in bottles instead of being distributed in pipes, or that it is purchased on recommendation of physicians (R. 14) instead of being used indiscriminately, should not serve to differentiate the cases or obscure the fact that the activity is undertaken for the governmental purpose of promoting the public health and not for purely commercial or profit-making reasons.

The use which is made of water distributed by the government should not affect the governmental character of the distribution. Water from a municipal waterworks is commonly sold to private industry as well as to domestic consumers. But any distribution of water by the state or a municipality is made in response to the genuine public interest in the subject matter.

Nor does the fact that part of the water is sold outside New York State (R. 15) affect the case. The Government has not sought to differentiate between sales to New York residents and sales outside. Just as State universities are open on special terms to non-residents, the health-giving waters of Saratoga Springs may be made available to anyone who wishes them, without discrimination based on residence.

Public development of the waters at Saratoga is merely another example of the long-established policy of New York, expressed by Governors of both political persuasions, that water resources should be kept in public ownership. As Governor Charles Evans Hughes put it:

> "* * * In the light of exact information, a proper policy with reference to the development and control of water powers should be established in order that these important sources of our prosperity may be held to the utmost extent possible for the benefit of all the people." Public Papers of Governor Hughes 1908, p. 33.

See also Public Papers of Governor Martin H. Glynn 1914, pages 1209-10; Public Papers of Governor Alfred E. Smith 1920, page 337; Public Papers of Governor Franklin D. Roosevelt 1929, page 13; Public Papers of Governor Thomas E. Dewey 1943, page 22.

Cf. *Kaukauna Water Power Co.* v. *Green Bay Canal Co.*, 142 U. S. 254.

The states always retain a substantial "reserve power" over their natural waters, even after conveyances to private

interests. *Cf. Illinois Central R. R. Co.* v. *Illinois,* 146 U. S. 387; *Coxe* v. *State,* 144 N. Y. 396; *Matter of Niagara Falls Power Co.* v. *Water Power and Control Commission,* 267 N. Y. 265, 276.

The public interest in water resources within the State was a ground for special treatment of a New Jersey statute forbidding exportation of water. *Hudson Co. Water Co.* v. *McCarter,* 209 U. S. 349. The Court in that case permitted a prohibition against sale of water to non-residents, although such a distinction between citizens of different States would not have been permitted with respect to other types of property. *Cf. Pennsylvania* v. *West Virginia,* 262 U. S. 553.

No fancied similarity between the uses of whisky and of water should be permitted to obscure the fact that the State of New York is here engaged in a legitimate governmental activity which is entitled to protection from all direct tax burdens by any other sovereignty.

We are not unaware that a distinguished commentator, impressed by the decision in *South Carolina* v. *United States,* 199 U. S. 437, has stated concerning the case now *sub judice* that, "It will, however, occasion surprise if the Supreme Court should find a constitutional immunity for state furnished mineral water that it does not find for state furnished alcoholic spirits". T. R. Powell, *The Remnant of Intergovernmental Tax Immunities,* 58 Harv. L. Rev. 757, 794n. We might reply in the same vein that it would occasion surprise if any one made the mistake of mixing the laxative or diuretic waters of Saratoga Springs with whisky to form a highball. The waters are valued primarily for their medicinal virtues (R. 12, 14) and would be distasteful as a beverage component.* The language,

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* "they are not suitable for indiscriminate beverage use and cannot be mixed with fruit juices or alcoholic beverages" (Stipulation of Facts, par. 13—R. 14).

moreover, disregards the differences which this Court has already recognized in the *Brush* case, between the functions which a state subserves in distributing whisky and those which it subserves in distributing water.

The extent to which the State's development at Saratoga Springs subserves vital public interests may be seen from examination of the report submitted to the Legislature by the special Commission appointed in 1929 (1930 N. Y. Leg. Doc. No. 70—hereinafter called "Report"). This Commission, of which Bernard M. Baruch was chairman, reported that

> "the Commission and its expert advisers alike are convinced that an institution may be built up at Saratoga for the effective treatment of the chronically ill and those in danger of becoming so, especially those suffering from cardiac, vascular and circulatory ailments—ailments whose victims in the United States now number more than 235,000 each year, the greatest toll taken by any one group of diseases, and for whose treatment, it is agreed, the waters at Saratoga have great virtue." (Report, p. 5).

The Commission considered that it was "most necessary" that control of all use of the waters be placed under the State (Report, p. 9).

The analysis of comparable spas of the eastern United States (Report, pp. 51-66) shows that the development by New York State at Saratoga is not unique as a public venture, and that any contrary implications in the stipulation of facts (par. 20, R. 19) should not be relied upon.

The Report shows that the forty-four springs at Hot Springs, Arkansas have been the property of the United States Government for over a century, having been set aside as a national reservation in 1832, and made a national park, under the Department of the Interior, in 1921 (Report, p. 52). The bath houses at Hot Springs pay an annual fee for water, which is "piped direct from the

springs, the entire system of distribution being in the hands of the Government" (Report, p. 53).

The Report also shows that Berkeley Springs, West Virginia, is owned by the State, having been ceded to the Colony of Virginia by Lord Fairfax about the time of the French and Indian War (Report, p. 64); and that the Big Horn Hot Springs at Thermopolis, Wyoming, have been operated as a State reserve since 1897, when they were ceded to the State by the United States Government (Report, p. 65).

During the very time that the Federal Government has been disputing the governmental character of the State's activities at Saratoga Springs, a federal agency (the United States Veterans' Administration) has taken over one of the bath houses on the Saratoga Springs Reservation, and since February 1, 1943 it has been used "for administering the natural mineral water treatments to cardiac, arthritic and convalescent cases". New York Legislative Manual (1944) 553. So we have the strange situation here of two governments jointly using a single property, and the one claiming that, while its own use is admittedly governmental, it is entitled to tax the other on the theory that its activities are not governmental.

POINT III

The fact that a state, in enlarging its property or activities, enters a field which would be taxable as a private enterprise, does not constitute a ground for denying tax immunity.

The limitation upon the general principle of immunity is to be found at the exact point where it collides with and is outweighed by a competing principle. A state by enlarging its property ownership or its activities may "withdraw" from the reach of the federal taxing power

property and income which are normally subject to federal taxation when owned and received by private persons, to the point and only to the point, where the impropriety of one sovereign taxing another without its consent becomes outweighed by some competing constitutional principle of exigent federal interest.

Where the need of preserving federal revenue is the only competing principle, it is our view that the state's immunity should control, at least until there is an actual danger of serious impairment of the federal revenue.

There is nothing novel or unduly burdensome in this answer to the present question. In *Thomas* v. *Collins*, 323 U. S. 516, 544, Mr. Justice Jackson said: "As frequently is the case, this controversy is determined as soon as it is decided which of two well-established, but at times overlapping, constitutional principles will be applied to it." Mr. Justice Holmes stated the same thought in *Irwin* v. *Gavit*, 268 U. S. 161, 168: "Neither are we troubled by the question where to draw the line. That is the question in pretty much everything worth arguing in the law."

Both the state and federal governments from time to time own property or engage in activities which would be taxable in the hands of a private person. This fact in itself does not constitute a basis for denying immunity.

In *United States* v. *Railroad Company*, 17 Wall. 322, the question was the right to levy a withholding tax on the interest on bonds of the Baltimore & Ohio Railroad, owned by a municipal corporation. Clearly the interest from such bonds would have been taxable if they were in the hands of a private person. But that fact was not considered as justifying a denial of immunity or even an examination into the propriety of the investment. See 17 Wall. at 330-31.

The second question propounded by this Court on October 8th, relating to the "withdrawal" from federal tax-

ing power of property and income which would be subject to that power when owned or received by private persons, refers to "*United States* v. *California*, 297 U. S. 175, 184, 185, and cases cited."

We do not read *United States* v. *California* as holding that a state's venture into a field partly occupied by private enterprise necessarily subjects the state to tax. The issue in the case was the liability of the State of California for a statutory penalty for violation of the Federal Safety Appliance Act in the operation of a state-owned railroad serving the San Francisco Harbor. It was held that the claim of immunity should be denied. On the other hand, in a later case the same state's raisin marketing program was held immune from the Sherman Act, the test being stated as, "accommodation of the state and national interests involved." *Parker* v. *Brown*, 317 U. S. 341, 362. We suppose the test in the earlier case, likewise involving the relationship between the state's police power and the power of Congress under the commerce clause, to have been not substantially different. With respect to the governmental nature of the state activity involved in the earlier case of the harbor railroad the Court stated (297 U. S. at p. 183):

> "Despite reliance upon the point both by the government and the state, we think it unimportant to say whether the state conducts its railroad in its 'sovereign' or in its 'private' capacity. That in operating its railroad it is acting within a power reserved to the states cannot be doubted. See *Puget Sound Power & Light Co.* v. *Seattle*, 291 U. S. 619, 624; *Green* v. *Frazier*, 253 U. S. 233; *Jones* v. *Portland*, 245 U. S. 217."

The Court said of the state's reliance on tax immunity cases in connection with an interstate commerce issue that the analogy was "not illuminating" (p. 184). We shall show at a later point that the cases which the Court cited in connection with intergovernmental immunity are

consistent with the test which we have suggested in this brief. For the present it is sufficient to observe that the Court, after discussing the restrictions upon the federal taxing power, stated, "but there is no such limitation upon the plenary power to regulate commerce" (p. 185).

The case of *United States* v. *California*, in the emphasis it placed upon the commerce clause, is similar to *Veazie Bank* v. *Fenno*, 8 Wall. 533, where like emphasis was placed upon the currency power (pp. 548-549), or *Board of Trustees* v. *United States*, 289 U. S. 48, which held a state subject to the tariff act as an exercise of Congress' power "to regulate commerce with foreign nations" (p. 56). These cases are examples of specific federal regulatory powers which were held preponderant, but they do not prove that the general federal power of taxation for revenue, which has always been held subject to implied limitations in intergovernmental relations, should now be considered necessarily and always supreme.

We have suggested that the rule to be deduced from the decided cases, and from the nature of our constitutional government, is that any property which a state acquires and any activity which a state or political subdivision undertakes in order to furnish a public service to the inhabitants of the state or nation is constitutionally immune from federal taxation.

In analyzing the bases of state immunity we shall argue (1) that the states should be given the same freedom from tax burdens in enlarging their activities within the fields reserved to the states that the federal government has within the powers delegated to it; (2) that the general principles of state and federal immunity have been traditionally regarded as reciprocal and should continue to be so regarded; and (3) that no previous case has sustained a federal tax upon a public service rendered by a state or political subdivision.

(1) The states should be given the same freedom from tax burdens in enlarging their activities within the fields reserved to the states that the Federal Government has within the powers delegated to it.

It is not necessary to remind this Court how far the Federal Government has expanded its activities beyond what the founding fathers could have specifically foreseen in 1787. Government corporations are numbered by the score (see *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U. S. 381, 390n.), and departments themselves have engaged in businesses which might be described as comparable in character to private business. In fact this Court has observed of at least one Government corporation that its activities are "akin to those of private enterprises." *Reconstruction Finance Corp.* v. *Menihan Corp.*, 312 U. S. 81, 83.

All of these activities of the Federal Government have been declared governmental. The theory is that the Federal Government being one of delegated powers, any constitutional exercise of its powers must be governmental *Federal Land Bank* v. *Bismarck Lumber Co.*, 314 U. S. 95, 102; *Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466, 478. Accordingly, any proper activity of the Federal Government is exempt from state or local taxation, unless Congress indicates a contrary intent. *City of Cleveland* v. *United States*, 323 U. S. 329, 333.

The governmental powers of the states, however, can be no less, within the fields reserved to the states, than the powers which the states have delegated to the Federal Government.

It has always been a function of government to supply to its citizens those services which for various reasons can be more advantageously rendered by the public than by private enterprise. As respects many of these services, the necessity of paying federal taxes would actually hamper the state in carrying on the activity, and might even pre-

vent the state from furnishing it to its citizens at a reasonable cost. In undertaking such projects as the distribution of water, the furnishing of low-cost housing, the building of bridges and the collection of garbage, and the operation of subways and other transit facilities, it is clear that states and cities are not actuated by commercial motives but by the same desire to fulfill the necessary functions of government which has led the Federal Government into new fields in recent years. There is no dependable historic basis for affirming that a specific activity has never been a part of state government, and no foresight is capable of affirming that a specific activity will never become an essential part of state government.

The same finding which the District Court made with respect to the State's sale of bottled waters, that it "had the characteristics of a business enterprise, and the waters referred to were sold in competition with private waters" (R. 27), could be made with reference to any number of federal activities with equal force.

This Court has not assumed to limit the expansion of activities by the states or to question the propriety of steps which do not infringe the due process clause or other provisions of the Federal Constitution. As was said in Mr. Justice Stone's opinion in *Puget Sound Power & Light Co.* v. *Seattle*, 291 U. S. 619, 624:

> "'In conducting the business by state authority the city is exercising a part of the sovereign power of the state which the Constitution has not curtailed. The decisions of this Court leave no doubt that a state may, in the public interest, constitutionally engage in a business commonly carried on by private enterprise, levy a tax to support it, *Green* v. *Frazier*, 253 U. S. 233; *Jones* v. *Portland*, 245 U. S. 217, and compete with private interests engaged in a like activity. *Standard Oil Co.* v. *Lincoln, supra; Madera Water Works* v. *Madera* 228 U. S. 454; *Helena Water Works Co.* v. *Helena*, 195 U. S. 383."

The broad extent of the states' powers is expressly recognized by the Tenth Amendment, which provides:

> "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

It should not be forgotten that it was the people of the States, as independent sovereignties, which ratified the Constitution and created the United States. WARREN, *The Supreme Court and Sovereign States* [1924] Apdx. B, pp. 105-112. As Mr. Justice William Johnson said, dissenting in *Bank of United States* v. *Planters' Bank of Georgia*, 9 Wheat. 904, 912, "in every possible form and shape, it is a sovereign state, or it is nothing".

The right of the states to enter new fields of activity under their reserved powers has contributed greatly to the progress of our country. As Mr. Justice Brandeis pointed out:

> "a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country". *New State Ice Co.* v. *Liebman*, 285 U. S. 262, 311.

The importance of tax immunity to give to the states the sovereign position to which they are entitled under the Constitution has been stated more than once.

> "The States are essential parts of the plan adopted by the Federal Constitution; and we accept as settled doctrine that the United States can lay no tax upon their governmental instrumentalities." (*Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, 400.)

The contention advanced by the United States in this case, that any activity of a state which smacks of a business nature is outside the scope of governmental immunity, sounds in strange contrast to the views of the late

Governor Alfred E. Smith of New York about the conduct of government affairs. In his messages to the Legislature he often referred to the State's work in terms of business:

> "In the last analysis, we will have to deal with but very few strictly political problems. The activities of the great corporation known as the State of New York are almost entirely concerned with the strictly business side of government and the welfare or human side" (Annual Message Jan. 7, 1925—N. Y. Leg. Doc. No. 3, p. 4). (See also Annual Message Jan. 6, 1926—Public Papers of Governor Alfred E. Smith 1926, pp. 29-30.)

The fact that the Federal Government is exercising new powers in many fields should not be permitted to obscure the continued importance of the states themselves. Woodrow Wilson treated this problem with statesmanlike foresight in his lectures on "*Constitutional Government in the United States*" (1908). After describing the nationalizing process which was even then under way, he stated (p. 49):

> "But there are natural limits beyond which such a development cannot go, and our state governments are likely to become, not less, but more vital units in our system as the natural scope and limits of their powers are more clearly and permanently established".

The whole of Chapter VII of President Wilson's book, dealing with the relation between the states and the Federal Government, is of interest. We quote only a paragraph, dealing with the extent of the states' powers:

> "The presumption insisted upon by the courts in every argument with regard to the powers of the federal government is that it has no power not explicitly granted it by the federal Constitution or reasonably to be inferred as the natural or necessary accompaniment of the powers there indisputably conveyed to it;

but the presumption with regard to the powers of the States they have always held to be of exactly the opposite kind. It is that the States of course possess every power that government has ever anywhere exercised, except only those powers which their own constitutions or the Constitution of the United States explicitly or by plain inference withhold. They are the ordinary governments of the country; the federal government is its instrument only for particular purposes". (pp. 183-4).

The nature of the relation between the states and the Federal Government requires that legitimate state activities within the reserved powers of the states be left, so far as possible, free from any federal burdens or interference.

As Thomas Jefferson put it:

"The capital and leading object of the Constitution was to leave with the States all authorities which respected their own citizens only, and to transfer to the United States those which respected citizens of foreign or other States: to make us several as to ourselves, but one as to all others." (Letter to Mr. Justice Johnson, June 12, 1823, 15 The Writings of Thomas Jefferson [Lipscomb ed. 1905] 439.)

Hon. Franklin D. Roosevelt while he was Governor of New York said, in a radio address on States' Rights:

"Thus, already it was clear to the framers of our Constitution that the greatest possible liberty of self-government must be given to each state, and that any national administration attempting to make all laws for the whole nation, such as was wholly practical in Great Britain, would inevitably result at some future time in a dissolution of the Union itself." (Public Papers of Governor Franklin D. Roosevelt 1930, p. 710.)

The rapid expansion of social legislation by Congress in recent years should not be permitted to obscure the fact that the states have truly been the experimental laboratories throughout the history of our land. New

York created a State Insurance Fund for workmen's compensation in 1914 (L. 1913, c. 816; L. 1914, c. 41; Workmen's Compensation Law, Art. 6), before there was any federal provision either for workmen's compensation (the Longshoremen's and Harbor Workers Compensation Act was passed in 1927, 33 U. S. C. A. § 901, *et seq.*) or for insurance activity of any sort (*e. g.*, War Risk Insurance, War Damage Corporation, Federal Crop Insurance Corporation, etc.). Massachusetts (in 1874) was the first state to enact a ten-hour law for women (8 *Encyclopedia of the Social Sciences* 660). Nebraska insured bank deposits (see *Noble State Bank* v. *Haskell*, 219 U. S. 104, 575) long before there was a Federal Deposit Insurance Corporation. North Dakota undertook both farm marketing and public housing (*Green* v. *Frazier*, 253 U. S. 233) before there was either a Commodity Credit Corporation or a Federal Housing Administration. Oregon had minimum wage laws long before there was any Federal Fair Labor Standards Act (*Muller* v. *Oregon*, 208 U. S. 412). New York built the Erie Canal as a state enterprise in 1825, long before the Federal Government took over the Panama Canal from its private promoters or organized the Inland Waterways Corporation. And the list might be extended in similar fashion.

The scope of the federal income tax is so all-embracing that nothing would be left of state immunity if any activity, which in private hands would be subject to the income tax, was thereby taxable in the hands of the state as having been "withdrawn" from the federal taxing power.

No one can tell what future advances may be hampered if this court sanctions the burdening of any new state activity with federal taxes.

Many new activities would be seriously handicapped if they were required to pay federal taxes. A major reason for enlargement of state and municipal activities has been

the inability of private enterprise to furnish satisfactory services profitably. This is surely true in the transit field, and to some extent explains the taking over of highway construction as a governmental activity.* It is clear, moreover, that existing rules of immunity have not hampered the unprecedented tax programs of the war years.

This Court in very recent decisions has recognized the wisdom of not intruding upon the powers of the states. *Spector Motor Service, Inc.* v. *McLaughlin*, 323 U. S. 101; *Ford Motor Co.* v. *Department of Treasury*, 323 U. S. 459. The Court has declared that a state statute cannot be condemned as in conflict even with express national legislation unless the conflict is clearly shown. *Alabama State Federation of Labor* v. *McAdory*, 325 U. S. , 65 Sup. Ct. 1384, 1392 (June 11, 1945); compare *North Carolina* v. *United States*, 325 U. S. , 65 Sup. Ct. 1260, 1263 (June 11, 1945). By the same token the immunity inherent in any state activity should not be overruled as inconsistent with the Constitution unless there is some clear and compelling reason.

It is surely not in keeping with the respect this Court has expressed for the states, to take a niggardly or grudging attitude toward the extent of the states' governmental power to exercise the rights specifically reserved to them by the Constitution.

(2) The general rule is, and should continue to be, that the immunities of the States and of the Federal Government are reciprocal.

The decisions of this Court have established over a long period of years, that the immunity of the states from federal taxation is based on the same principles as the immu-

* Plank road corporations were chartered by the hundreds in the mid-nineteenth century, with power to improve highways and charge tolls, but the difficulties of private operation have forced the State to take over most highway activities (MAU, *The Development of Central and Western New York* [1944], 386-88).

nity of federal agencies from state taxation—in other words, that the two immunities are reciprocal.

The principle of federal supremacy within the fields delegated to the Congress may sometimes operate to enlarge the federal immunity or restrict that of the states, so that the latter may be held within narrower limits (*cf. Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466, 478, 489), but the basis of the two immunities is similar.

Chief Justice Marshall's words in *McCulloch* v. *Maryland*, 4 Wheat. 316, apply as well to a federal tax on a state agency as to a state tax on a federal agency.

> "If we measure the power of taxation residing in a state, by the extent of sovereignty which the people of a single state possess, and can confer on its government, we have an intelligible standard, applicable to every case to which the power may be applied. • • • We have a principle which is safe for the states, and safe for the Union. We are relieved, as we ought to be, from clashing sovereignty; from interfering powers; from a repugnancy between a right in one government to pull down, what there is an acknowledged right in another to build up; from the incompatibility of a right in one government to destroy, what there is a right in another to preserve. We are not driven to the perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use, and what degree may amount to the abuse of the power" (pp. 429, 430).

It is true that Marshall, after holding the Bank to be constitutional, invoked the supremacy clause of the Federal Constitution as one of his arguments to protect it, but the decision does not rest on that alone. The supremacy clause (Art. VI, § 2) applies to federal laws within the powers delegated to Congress, but state laws are equally binding within the fields reserved to the states. *Tompkins* v. *Erie Railroad Co.*, 304 U. S. 64; and *Cf.* 4 Wheat. at 410.

The fact that the initial opinion of the great Chief Justice in the *McCulloch* case discussed possible differences between the states and the federal goverment lends added weight to the statements in subsequent cases that the immunities of the two governments are founded on the same basis. It is not to be supposed that the judges who applied and repeated the doctrine of reciprocal immunity through the years were ignorant of what the opinion in the *McCulloch* case said. The *McCulloch* case was expressly referred to in one of the earliest cases to state the rule of reciprocal immunity, that of *New York ex rel. Bank of Commerce* v. *Commissioners of Taxes*, 2 Black 620, 635, where the Court stated:

> "Each is sovereign and independent in its sphere of action, and exempt from the interference or control of the other, either in the means employed or functions exercised * * *".

No other statement would have been consistent with the view expressed by the framers of the Constitution, that the taxing powers of the state and federal governments were to be concurrent. *The Federalist* (Ford ed. 1898) Nos. 30-36, esp. pp. 199, 212.

Nor may the *McCulloch* case be explained away as based on an outworn belief that the power to tax is the power to destroy. Chief Justice Marshall was expressing in vivid fashion the possible effect of a tax; but the principles of immunity, necessary to accommodate the respective interests of the state and federal governments, demand protection from taxes which interfere with sovereign operations as well as those which would utterly destroy them.

The rule of reciprocal immunity was clearly expressed in *Collector* v. *Day*, 11 Wall. 113, where Mr. Justice Nelson stated:

> "the States within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general govern-

ment as that government within its sphere is independent of the states" (p. 124).

> "in this respect, that is, in respect to the reserved powers, the State is as sovereign and independent as the general government. And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, equally exempt from Federal taxation? Their unimpaired existence in the one case is as essential as in the other" (p. 127).

This rule was repeated in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 584:

> "As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State."

The reciprocal nature of the immunity was acknowledged again by Mr. Justice Shiras in *Plummer* v. *Coler*, 178 U. S. 115, which held that a state inheritance tax might include United States bonds as part of the estate. He stated (p. 117):

> "It is not open to question that a State cannot, in the exercise of the power of taxation, tax obligations of the United States. *Weston* v. *Charleston*, 2 Pet. 449; *Bank of Commerce* v. *New York City*, 2 Black, 620; *Home Insurance Co.* v. *New York*, 134 U. S. 594, 598.
>
> So, likewise, it is settled law that bonds issued by a State, or under its authority by its public municipal bodies, are not taxable by the United States. *Mercantile Bank* v. *New York*, 121 U. S. 138, *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 583.
>
> The reasoning upon which these two lines of decision proceed is the same."

Similarly, Chief Justice Fuller, in *Ambrosini* v. *United States*, 187 U. S. 1, construing a statute exempting state bonds from stamp taxes, stated (p. 7):

> "The general principle is that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government."

Again in *Farmers and Mechanics Savings Bank* v. *Minnesota*, 232 U. S. 516, Mr. Justice Pitney, in forbidding a state to tax bonds issued by municipalities in Indian Territory, stated, after quoting the rule that a tax on government bonds is a tax on the operation of government, that (pp. 526-527):

> "It is on this ground that United States bonds have always been held exempt from taxation under authority of the States. By like reasoning it has come to be recognized that bonds issued by the States are not taxable by the Federal Government."

In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 521, the Court said:

> "We pass to the more difficult question whether Congress had the constitutional power to impose the tax in question, and this must be answered by ascertaining whether its effect is such as to bring it within the purview of those decisions holding that the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of a state government, and *in a similar manner* to limit the power of the states to tax the instrumentalities of the federal government."

Mr. Justice Stone in *Educational Films Corp.* v. *Ward*, 282 U. S. 379, 389, stated that "the instrumentalities of either government, or the income derived from them, may not be made the direct object of taxation by the other."

The reciprocal nature of the immunities was reiterated in *Trinityfarm Construction Co.* v. *Grosjean*, 291 U. S. 466, where a state excise tax on gasoline purchased by a federal contractor was held to have only a remote effect upon the federal government. Speaking of the principle that a state could not tax a federal instrumentality the Court said (p. 471):

> "That principle, while not expressly stated in the Constitution, necessarily arises out of our dual government. It has often been given effect. And reciprocally it safeguards every State against federal tax on its governmental agencies or operations."

Reciprocity seems also to be assumed by Mr. Justice Stone in *United States* v. *California*, 297 U. S. 175, 184, where he states that:

> "Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing power, see *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 522-524, which would be unduly curtailed if *either* by extending its activities could withdraw from the taxing power of the other subjects of taxation traditionally within it."

Cf. Cardozo, J., dissenting, in *Ashton* v. *Cameron County Water Improvement District*, 298 U. S. 513, 540.

Both opinions in the *Brush* case recognized the rule of reciprocal immunity. The majority opinion stated:

> "The unimpaired existence of both governments is equally essential. It is to that high end that this court has recognized the rule, which rests upon necessary implication, that neither may tax the governmental means and instrumentalities of the other" (300 U. S. at 364).

The dissenting opinion of Mr. Justice Roberts, with whom Mr. Justice Brandeis joined, stated (300 U. S. at 375):

> "It seems to me that the reciprocal rights and immunities of the national and a state government may

be safeguarded by the observance of two limitations upon their respective powers of taxation. These are that the exactions of the one must not discriminate against the means and instrumentalities of the other and must not directly burden the operations of that other."

See also *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, 575;

New York ex rel. Cohn v. *Graves*, 300 U. S. 308, 315-16;

Helvering v. *Therrell*, 303 U. S. 218, 223;

Hon. Stanley Reed, *The State Today*, 15 Tenn. L. Rev. 52, 62 (1937);

COOLEY, *Constitutional Limitations* (1868) p. 483.

So, developments in the law of federal and state tax immunity have run hand in hand.

Thus, *Dobbins* v. *Commissioner*, 16 Pet. 434, exempting the salaries of federal officers from state taxation, was followed by *Collector* v. *Day*, 11 Wall. 113, exempting the salaries of state officers from federal taxation, and "for like reasons." See *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, 577.

Conversely, *United States* v. *Perkins*, 163 U. S. 625, permitting a state tax upon a bequest to the Federal Government, as an excise upon the power to transmit by will, was followed by *Snyder* v. *Bettman*, 190 U. S. 249, upholding a federal tax on legacies to states or municipalities.

When this Court approved a federal tax on the income of a lessee of state oil land (*Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376), it expressly overruled both the case which had previously forbidden such a federal tax (*Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393) and also the decision which had forbidden a state tax upon the in-

come of a lessee of restricted Indian lands (*Gillespie* v. *Oklahoma*, 257 U. S. 501).

When the Court determined that a tax on salaries was not a direct burden on the government paying the salaries, its decision permitting a federal tax on salaries of state officers (*Helvering* v. *Gerhardt*, 304 U. S. 405) was quickly followed by a decision permitting a state tax on the salaries of federal officers. *Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466.

The statement which the Court has recently made, that any constitutional exercise of federal powers must be governmental, because the Federal Government has only delegated powers (*Federal Land Bank* v. *Bismarck Lumber Co.*, 314 U. S. 95, 102), must be supported by some unexpressed minor premise, either that the states (or their people) which delegated the power to the Federal Government possessed only governmental powers, or that their intention was to delegate only governmental powers. Under the first alternative, every activity of a state must be treated as governmental; under the second, any activity in which the Federal Government participates must also be governmental when undertaken by a state or municipality.

The argument that the states have less need of immunity than the Federal Government, because they are represented in Congress (see *Helvering* v. *Gerhardt*, 304 U. S. at 416), cannot be pressed too far. Such an answer is never in itself a satisfactory response to a constitutional question. Wisconsin was represented in the Congress when it passed the Home Owners' Loan Act of 1933, yet Mr. Justice Cardozo for a unanimous Court held that the Congress did not have power under the Federal Constitution to authorize a state-chartered savings and loan association to convert into a federal association without the consent of the state. *Hopkins Federal Savings and Loan Association* v. *Cleary*, 296 U. S. 315. The truth is that so

many complicated elements influence the final passage of a Congressional act that it would be a mistake to regard it in every case as representing the final word on the rights of the states under the Constitution. Moreover, long-range planning, essential to large public projects, would be subject to new difficulties if the immunity of the project were to depend upon the will of fluctuating majorities in Congress rather than upon the relative security of constitutional doctrine. Approaching the point from another angle, it has been suggested that the power of Congress to protect a federal enterprise from state taxation is a power of self-defense that no state possesses through its own legislature. T. R. Powell, *The Waning of Intergovernmental Tax Immunities,* 58 Harv. L. Rev. 633, 653-54, 649.

Incongruous and unhappy results may follow from failure to adhere to the principle of reciprocity.

It may be suggested that the principle of reciprocal immunity is unimportant here because the Federal Government does not sell *bottled* mineral water (R. 19). It is within the realm of possibility, however, that the Federal Government may at some time bottle and sell water from the geysers at Yellowstone Park or from the springs which it owns at Hot Springs, Ark. It is engaged in many other activities in the National Parks which are of a commercial nature. See Report of the Secretary of the Interior for the fiscal year ending June 30, 1941, describing the activities of National Park Concessions, Inc., a non-profit corporation organized to operate concession facilities—page 279; same for 1942, page 163; same for 1943, page 217. A holding that the sale of water from Saratoga Springs is not a governmental activity would require a parallel holding, if the Department of Interior should ever seek to sell mineral waters, that it was not within the governmental powers delegated to the United States.

To take another example, the Federal Government is developing power from the Tennessee River, and this Court has stated that in so doing it is "performing a governmental function." *Graves* v. *Texas Company*, 298 U. S. 393, 395.* One of the early T. V. A. contracts was with the cities of Tupelo, Miss. and Athens, Ala., which owned municipal distribution systems. PRITCHETT, *The Tennessee Valley Authority, A Study in Public Administration* (1943) 67. The distribution of electricity must be as much a governmental function as the production of that same electricity, yet the position urged by the United States in this case might require that the two be treated differently.

The housing field likewise emphasizes the need of applying reciprocal immunity. The same public needs which have led the Federal Government to assist in providing housing for low-income groups have impelled the states to erect housing developments at public expense (N. Y. Const., Art. XVIII; N. Y. Public Housing Law). The provision of housing is not a traditional governmental activity in the narrow sense, but it responds to a public need and to local conditions, which the states should have freedom of action to remedy. Yet a denial

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* The decision of the three-judge district court listed the Tennessee Valley Authority as one of the federal agencies to which the Texas Company was selling gasoline. *Texas Co.* v. *Carmichael*, 13 F. Supp. 242, 248n. Circuit Judge Hutcheson, in his dissenting opinion in that court, pointed out that:

> "If the establishment of departments of liquor control, as in the South Carolina and Ohio cases, and the operation of a railroad, as in Helvering v. Powers, are not the exercise by the state of ordinary and usual governmental functions within the principle of exemption from federal taxation, it would seem probable that some of the agencies which plaintiff's gasoline will activate will not be within the principle of exemption from state tax" (13 F. Supp. at 249).

of the doctrine of reciprocal immunity might hamper state housing by permitting the imposition of an income tax on the revenues of a housing authority if they exceed the normal depreciation of the buildings, or even on the interest paid to holders of housing authority bonds.

If this Court were to hold that state activities may be subject to any non-discriminatory tax which the Federal Government undertakes to levy, the result would be to put the States at a serious disadvantage in meeting the needs of their citizens.

(3) No previous case has sustained a federal tax upon a public service rendered by a state or political subdivision.

The rule of tax immunity commences with the sense that there is something unseemly and constitutionally objectionable in one government imposing taxation on another. This objection extends to any activity by which a government is serving a genuine public purpose.

In determining the extent of state activities which may be accorded tax immunity, the Court should apply the principle it has announced in other connections, that "there is wide discretion on the part of the legislature in determining what is and what is not necessary—a discretion which courts ordinarily will not interfere with" *Manigault* v. *Springs*, 199 U. S. 480-81, quoted in *East New York Savings Bank* v. *Hahn* 325 U. S. . (Nov. 5, 1945).

This Court has not, we are sure, meant to import the artificial distinctions of tort law into constitutional law by referring to "governmental" functions as the limit of state immunity. The tort cases were referred to by way of analogy only in the *South Carolina* case, 199 U. S. at 461, and the confusion which existed in the field of tort law was one of the grounds for the dissent in that case (p. 471). The intervening years have only added to the

confusion.* Recently Mr. Justice Black has pointed out the latitude for dispute which exists in defining "essential governmental functions." *Helvering* v. *Gerhardt*, 304 U. S. at 426.

Analysis of the practical effect of this Court's prior decisions concerning immunity of state activities supports as a minimum rule of state immunity, that any genuine public service rendered by states or municipalities is essentially "governmental" and is entitled to immunity from federal taxation. That immunity may attach, although the service was once largely within the field of private enterprise, and still is covered in part by private agencies, is shown by *Brush* v. *Commissioner*, 300 U. S. 352, 371, where this Court held that the supplying of water should be recognized as a governmental function.

It is noteworthy also that the opinion in the *Brush* case refused to be controlled by local law as to classification of activities for tort liability (300 U. S. at 363-65). A comparable instance where this Court refused to transfer common law distinctions (as to the difference between "employee" and "independent contractor"), into another field is *National Labor Relations Board* v. *Hearst Publications, Inc.*, 322 U. S. 111 (see particularly pp. 120-22 and 126-29). In the field of state immunity from direct taxation, there is ample justification for this Court's adopting a standard of what is "governmental" which would include all public services and exclude only commercial enterprises which were embarked upon for profit alone.

The fact that the issue related to a claimed exemption from personal income tax must be borne in mind in considering *Helvering* v. *Powers*, 293 U. S. 214, which is cited (United States brief, p. 13) for the proposition that the

* New York has recently cut the Gordian knot by imposing liability for all acts not only of the state, but also of municipal corporations, whether previously considered proprietary or governmental. Bernardine v. City of New York, 294 N. Y. 361.

operation of a street railway lies outside the scope of constitutional state immunity. The statements in that case that operation of the street railway system directly by the State Government would not bring immunity from federal taxing power were not necessary for the decision of the case, for there were substantial indications that the officers whose salaries were there sought to be exempted were not truly state officers. Although appointed by the Governor to manage the affairs of the Boston Elevated Railway Company, they received their compensation from the company (p. 220) and the property of the company remained in private ownership (p. 223). A holding that such state-appointed managers of a private company were governmental instrumentalities would scarcely have been consistent with prior rulings that receivers of private corporations, appointed by federal courts, were not governmental instrumentalities (*Michigan* v. *Michigan Trust Co.*, 286 U. S. 334; *Gillis* v. *California*, 293 U. S. 62). Moreover, the *Powers* case was decided before this Court had held in *New York ex rel. Rogers* v. *Graves*, 299 U. S. 401, that the operation of a railroad by the Federal Government was an activity entitled to immunity from state taxation. The *Powers* case was apparently not cited in the *Rogers* case, but it may be doubted whether the same reasoning would have been stated thereafter.

There are three cases cited in the United States brief (pp. 12-13) in which the States have been denied immunity from taxes imposed directly upon state activities.

South Carolina v. *United States*, 199 U. S. 437;
Ohio v. *Helvering*, 292 U. S. 360;
Allen v. *Regents*, 304 U. S. 439.

All these cases are consistent with recognition of immunity in the present case, provided that their facts be viewed as this Court viewed them when it decided them, and not as it might now view them. None of them involved the furnishing of a public service necessary to the citizens of the State, and in each of them there were ex-

ceptional circumstances which seemed to outweigh the principle of state immunity.

In *South Carolina* v. *United States*, 199 U. S. 437, the majority opinion of this Court said it was confronted with a threat to the "whole body of internal revenue tax" (p. 454). It could perceive no relevant difference between state sale of liquor through dispensaries, and sale, "in like manner, of tobacco, oleomargarine, and all other objects of internal revenue tax." The extent of the Court's fears, and the bearing on the ultimate decision of its antipathy to public ownership, are exemplified in the following quotation from Mr. Justice Brewer's opinion (p. 454):

> "If one State finds it thus profitable other States may follow, and the whole body of internal revenue tax be thus stricken down.
>
> More than this. There is a large and growing movement in the country in favor of the acquisition and management by the public of what are termed 'public utilities', including not merely therein the supply of gas and water, but also the entire railroad system. Would the State by taking into possession these public utilities lose its republican form of government?"

The majority's concern over the threat to private business is also indicated by its quotation at page 457. It may be that persons today will consider those several alarms excessive, as did the three dissenting justices in that case (pp. 470-472), but for purposes of understanding the decision the statement of the case by the majority is the true guide, and the majority saw abundant reason why the principle of state immunity was outweighed.*

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* Acting United States Attorney-General John W. Davis distinguished the *South Carolina* case in an opinion which ruled that the Pennsylvania Workmen's Compensation Fund was exercising an "essential governmental function", suggesting that the earlier case was based on "some peculiar circumstances connected with it, as e.g., the direct entrance of the State into the liquor business for a profit, and the lack of clear connections between such a business connection and any real regulation of the liquor traffic, so that the court was justified in describing it as a 'private business'". 31 Ops. Atty. Gen. 308, 317 (1919).

The *South Carolina* case can best be understood in the light of the sources of federal revenue at the time. In 1905, when the case was decided, over one-fourth of the entire annual income of the Federal Government was derived from taxes on spirits and fermented liquors.* It is understandable that the Court feared what might be the effect on the Federal Government if immunity were recognized and other states followed South Carolina's example. Clearly no such results would ensue if New York's sales of mineral waters were held to be free of a federal tax which amounts to only $4,473.50 (R. 22).

Ohio v. *Helvering*, 292 U. S. 360, was decided upon an application to file an original suit in this Court, opposed by the United States upon the ground that it did not satisfy the jurisdictional requirements and was an injunction against collection of a Federal tax, forbidden by Revised Statutes § 3224. Apparently there was no argument and the briefs were of the summary nature suitable to a preliminary motion. Although the State attempted to distinguish the considerations which were prompting it to enter the liquor dispensary business in 1933 from those which moved South Carolina in 1895 (pp. 364-365), the opinion by Mr. Justice Sutherland referred to the South Carolina case as one "in no substantial respect distin-

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* The Annual Report of the Secretary of the Treasury on the State of Finances for the Fiscal Year ended June 30, 1905 shows the following figures:

Total receipts from all sources	$697,101,269.95 (p. 1)
Total internal revenue	234,187,976.37 (p. 467)
Total revenue on spirits	135,958,513.12 (p. 466)
Total revenue on fermented liquors	50,360,553.18 (p. 466)

By contrast the total tax receipts from all mineral or table waters during the fiscal year 1933 amounted to only $144,947.12 (See Revenue Revision, 1934, being Hearings before the Committee on Ways and Means of the House of Representatives, 73d Congress, 2d Session, p. 883), out of total revenue receipts of $2,037,701,617.66 (Annual Report of Secretary of the Treasury for 1933, p. 329).

guishable from the present one" (p. 368). The attempted distinction as to the sale of liquor, and particularly in Ohio in 1933, was dismissed as "altogether fanciful" (p. 369).

In *Allen* v. *Regents*, 304 U. S. 439, although it was assumed that the holding of athletic contests is an integral part of the program of public education conducted by Georgia (p. 449), the statistics recited at page 450 suggested doubt as to the closeness of the relationship,* and the case was viewed as one where a state had deliberately embarked upon a business for profit, to be judged by the liquor dispensary precedents (p. 451). As its final argument, the opinion referred to the "destruction of the federal power to tax which might result from a contrary decision," and relied upon all the alarms of the *South Carolina* case (p. 453).

The facts in the *Allen* case also weaken its validity as a holding that a tax may be imposed directly upon the State Government. In a large degree the burden of the tax fell on the football spectators. The Commissioner of Internal Revenue had ruled that state universities must collect the tax on admissions "because the burden of the tax falls, not on the state, but on the persons paying the admission charges" (*Allen* Record, p. 8). The Regents had accordingly paid over the tax in earlier years to the Treasury, and when a refund was denied abandoned any claim for that period, "believing that the basis of the Commissioner's refusal to refund was sound" (304 U. S.

* The same doubt is expressed in a report of the Carnegie Foundation for the Advancement of Teaching, quoted in a note on the District Court's decision in the *Allen* case. "The football contest * * * is not a student's game. * * * It is a highly organized commercial enterprise." (23 Va. L. Rev. 570, 577; Bulletin Number Twenty-three, Carnegie Foundation, American College Athletics, 1929, p. viii.)

at 446). They then resorted to the "expedient" (p. 446) of stating the amount as a tax on the ticket, but reciting that the liability to such tax was disputed, and that it would be retained as part of the admission fee unless it was finally determined that the University was subject to the tax (304 U. S. at 443). The only tickets on which tax was required to be paid were those sold to the general public, for students were admitted by virtue of an annual athletic fee which was free from tax (304 U. S. at 445n.). Although the opinion proceeded on the basis "that the tax is imposed directly on the state activity and directly burdens that activity" (304 U. S. at 449-50), this hypothesis must be taken at somewhat less than face value, for the reasoning under which the Court had upheld jurisdiction of the suit as one not forbidden by R. S. § 3224 (forbidding injunctions against the collection of a tax) was that "here the assessment is not of a tax payable by respondent but of a penalty for failure to collect it from another" (p. 449).

The policy of developing Saratoga Springs as a state health resort was adopted many years before the tax on bottled water was imposed and the tax was repealed after being in force for less than two years (Revenue Act of 1934, § 601-48 Stat. 762) (R. 13). There had been only one other short period, during World War I, when any tax was imposed on bottled waters (§ 313-c of 1917 Revenue Act—40 Stat. 312, repealed February 24, 1919—40 Stat. 1149).

The facts of the *South Carolina* case suggest that the extent of federal revenue dependent upon the particular field before the state enters it may be a factor in determining whether the state's normal tax immunity must yield. The Court explained the *South Carolina* case in *Murray* v. *Wilson Distilling Co.*, 213 U. S. 151 (where it held that South Carolina was entitled to sovereign im-

munity under the Eleventh Amendment, as against suit for liquor dispensary transactions) and stated that the issue in that case had been the State's power "to destroy a pre-existing right of taxation possessed by the government of the United States" (p. 173). This Court in *United States* v. *California* mentioned both the matter of "the activities in which the States have traditionally engaged" and the question whether either government "could withdraw from the taxing power of the other subjects of taxation traditionally within it" (297 U. S. 184-185); but it was not called upon to determine which was more important, the traditional character of the state activity or the traditional exercise of the federal taxing power.

We submit that it is more compatible with the reason of the rule to mark the limits of immunity by reference to previous federal taxes than by reference to previous state activity.

If every new state activity which might conceivably be made the subject of federal taxation were to be denied exemption, there would be little left of the principle of state immunity, for the field of federal excise taxation is almost limitless.

It is not consistent with the progressive attitude of this Court toward new state activities to say that they are undertaken at the risk of future federal taxation. Even if the Court still fears that the states, by undertaking activities which have been customarily the subject of special federal taxes, may create a sufficiently serious threat to the federal revenues to justify an exception to the general rule of immunity, as was made in the *South Carolina* case, the danger to the federal revenue from a state entering activities which are not at the time subject to federal tax is not sufficient to deny immunity.

These considerations only emphasize the fact that the sale of bottled water at Saratoga Springs is more like the supplying of water for a fee, held governmental in the *Brush* case, than the creation of a state monopoly for liquor sales, involved in the *South Carolina* case.

Giving due weight to the long line of cases which have declared immunity from a non-discriminatory tax imposed directly upon either State or Federal Government, to the doctrine that a state's disposal of natural resources and particularly of water is a governmental function, to the generally reciprocal character of state and federal tax immunities, to the policy of encouraging experimentation within the insulated cells of the states, and to the lack of any serious impairment here of the federal revenue, there appears to be no substantial ground for denying immunity to the State of New York in the present case.

Conclusion

Viewing this case as an isolated instance of state activity, we submit that the sale of bottled water at Saratoga Springs is entitled to immunity from federal taxation as a governmental activity in the interest of public health, and as an exercise of the State's undoubted right to control and dispose of the natural resources within its boundaries.

If the case be viewed as an occasion for reëxamining and restating the doctrine of intergovernmental tax immunity, we submit that this Court should abide by its oft-repeated declarations that the States are immune from taxes levied directly upon them even though non-dis-

criminatory, and that taxation is permitted, if at all, only where exceptional circumstances, not here present, give controlling weight to some competing principle.

The judgment appealed from should be reversed and the complaint dismissed.

Dated, Albany, N. Y., November 23, 1945.

NATHANIEL L. GOLDSTEIN,
Attorney-General of the State of New York,
Attorney for State of New York, Petitioner.

ORRIN G. JUDD,
Solicitor General.

WENDELL P. BROWN,
First Assistant Attorney-General.

HENRY S. MANLEY,
Assistant Attorney-General.

IRVING I. WAXMAN,
Deputy Assistant Attorney-General,
of Counsel.

We join in the foregoing brief.

DENIS J. HARRINGTON,
Attorney for Saratoga Springs Commission
and Saratoga Springs Authority.

JOHN A. SLADE,
of Counsel.

Appendix A.

Federal Taxing Statute

The tax here involved was imposed under the Federal Revenue Act of 1932. Section 615 (a) (5) thereof reads as follows:

> "There is hereby imposed * * * (5) upon all natural or artificial mineral waters or table waters, whether carbonated or not, and all imitations thereof, sold by the producer, bottler or importer thereof, in bottles or other closed containers, at over 12½ cents per gallon, a tax of 2 cents per gallon." (47 Stat. 265).

New York Statute

The statute regulating the Saratoga Springs Reservation at the time the Federal tax was imposed was Chapter 866 of the Laws of 1930, which contains the following provisions:

> "Section 1. **Commission established; organization; purpose.** A temporary state commission, to be known as the Saratoga Springs commission, is hereby created * * * for the purpose of ultimately developing the Saratoga Springs reservation as a state health resort and spa for use by the public for balneological, therapeutic and other similar healthful purposes. The development of such reservation for public health purposes is hereby declared a policy of the state * * *.
>
> "§ 5. **General powers and duties of commission.** The commission shall have the power and it shall be its duty, subject to the provisions of this act, to conserve, maintain, control and develop each and every part of the reservation property. * * * The commission may prescribe the terms upon which any excess of mineral water and gas not used on said reservation or used under such leases or concessions, shall be sold or distributed, and shall prescribe the names, labels and advertisements to be affixed to the

bottles or other vessels containing such waters, gases or other products, and may itself sell or dispose of the same. * * * The commission may make or cause to be made scientific studies and experiments concerning kinds of illnesses and diseases which lend themselves to the treatment of the mineral waters, products and facilities of the reservation, and shall exercise exclusive control and supervision over the manner and method of the use of the products and facilities of the reservation." * * *

"§ 10. **Projects to be planned and completed by commission.**

* * * *

The commission is hereby authorized and empowered to maintain and conduct the bath houses now on said reservation and such other bath houses as the commission may from time to time cause to be erected; to maintain and conduct the drink-halls on said reservation and such others as may be built under the supervision of the commission; and also to maintain and conduct the bottling plant now on said reservation and is further authorized and empowered to enlarge or rebuild the same or construct a new and more adequate one as, in its discretion, will be most advantageous." * * *

"§ 11. **Capital fund of commission.** * * * The commission shall deposit at least once in each week in the depository or depositories designated by the [state] comptroller all moneys received by it for all purposes."

Earlier statutes affecting the Reservation are referred to in the Stipulation of Fact (R. 31-32).